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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, A. D. 1942.

In the Matter of

THE CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,
Debtor.

GROUP OF INSTITUTIONAL INVESTORS and MUTUAL SAVINGS BANK GROUP,
Petitioners,

vs.

ST. LOUIS UNION TRUST COMPANY and ILLINOIS STATE TRUST COMPANY, as Trustees, et al.,
Respondents.

No. 12.

BRIEF

Of St. Louis Union Trust Company and Illinois State Trust Company, as Trustees, et al., Respondents.

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Of St. Louis Union Trust Company and Illinois State Trust Company, as Trustees, et al., Respondents.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals dated December 4, 1941, is reported in 124 Fed. (2d) 754 (R. 2297-2317). The per curiam opinion of the Circuit Court of Appeals dated January 12, 1942, on the petition to modify its opinion of December 4, 1941, is not reported (R. 2334-2335). The opinion of the District Court is reported in 36 Fed. Sup. 193 (R. 1857-1899).

JURISDICTION.

The jurisdiction of this Court has been invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, and under Sections 24 (c) and 77 of the Bankruptcy Act, as amended.

STATEMENT OF THE CASE.

Respondents St. Louis Union Trust Company and Illinois State Trust Company are Trustees under the indenture securing an issue of Chicago, Milwaukee and Gary Railway Company First Mortgage Five Per Cent Forty-Year Gold Bonds. Respondents Tower Grove Bank & Trust Company, St. Louis Realty and Securities Company and Loraine G. Franciscus are the holders of certain of said bonds. Said respondents appealed from the Findings of Fact, Conclusions of Law and Order and Decree approving a plan of reorganization for the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Debtor, under the provisions of Section 77 of the Bankruptcy Act, as amended, made and entered on the 13th day of November, 1940, by the United States District Court for the Northern District of Illinois, Eastern Division. The respondents contended in the Court below, and contend here, that the Interstate Commerce Commission failed to comply with the provisions of said Section 77 of the Bankruptcy Act, as amended; that said plan of reorganization does not comply with the provisions of Section 77 of the Bankruptcy Act, as amended, in that it is not fair and equitable, does not afford due recognition to the rights of each class of creditors and stockholders, discriminates unfairly in favor of various classes of creditors, and will not conform to the requirements of the law of the land regarding participation of the various classes of creditors therein; and that said plan of reorganization constitutes a taking of the property of the holders of said

bonds without due process of law, contrary to the Fifth Amendment to the Constitution of the United States.

There is little or no dispute as to the facts with respect to the Chicago, Milwaukee and Gary Railway Company First Mortgage Five Per Cent Forty-Year Gold Bonds (hereinafter referred to as "Gary Bonds"). However, the relevant portions of the statements of the case appearing in the briefs of petitioners are so incomplete that we deem it necessary to make a more comprehensive statement at this place.

These bonds were executed by the Chicago, Milwaukee and Gary Railway Company, as of April 1, 1908, and are secured by a first mortgage deed of trust of even date therewith, which mortgage is a first and prior lien upon approximately eighty-three (83) miles of railroad running from Delmar to Joliet, Aurora to Kirkland, and Camp Grant to Rockford, all in the State of Illinois, together with certain equipment and noncarrier property. The aggregate amount of Gary bonds issued under this mortgage was $5,798,000.00 face principal amount. Bonds of the par value of $98,000.00 have been duly canceled, so that the aggregate face principal amount of said Gary bonds now issued and outstanding is $5,700,000.00.

On or about the 31st day of December, 1921, a contract was entered into between the St. Louis Union Trust Company, acting therein as syndicate manager under an agreement dated June 25, 1913, as party of the first part, and Chicago, Milwaukee and St. Paul Railway Company, as party of the second part, wherein and whereby said St. Louis Union Trust Company agreed, inter alia: To deliver to the said Chicago, Milwaukee and St. Paul Railway Company said five million seven hundred thousand dollars ($5,700,000.00) in par value of said bonds, together with certificates for all of the issued and outstanding capital stock of the Chicago, Milwaukee and Gary Railway Com-

pany duly endorsed in blank. And by the terms of said agreement said Chicago, Milwaukee and St. Paul Railway Company agreed, inter alia:

1. To guarantee the payment of the principal of three million dollars ($3,000,000.00) in par value of said Gary bonds and the interest thereon accruing after January 1, 1924, and to make appropriate endorsement of said guaranty on each of said bonds, and to redeliver said three million dollars ($3,000,000.00) in par value of said bonds so endorsed to the said St. Louis Union Trust Company, which guaranty was agreed to be the consideration for the sale and delivery to the Chicago, Milwaukee and St. Paul Railway Company, of all of the capital stock and two million seven hundred thousand dollars ($2,700,000.00) par value of said bonds of the said Chicago, Milwaukee and Gary Railway Company.

2. To assume and take over the control, management and operation of the railroad of the said Chicago, Milwaukee and Gary Railway Company and to maintain and operate the same thenceforth at its own expense.

3. To maintain the railroad, equipment and appurtenances of the said Chicago, Milwaukee and Gary Railway Company on at least as high a standard as they were maintained at that time.

Said contract also provided that the agreements, covenants and obligations contained therein should extend to and be binding upon the successors and assigns of the parties thereto (R. 311).

Pursuant to said contract all of the certificates for all of the issued and outstanding capital stock of the Chicago, Milwaukee and Gary Railway Company were delivered to and became the property of said Chicago, Milwaukee and St. Paul Railway Company. Upon delivery of

said $5,700,000.00 in par value of said Gary bonds to said Chicago, Milwaukee and St. Paul Railway Company the said Chicago, Milwaukee and St. Paul Railway Company duly guaranteed the payment of principal of $3,000,000.00 in par value thereof and of interest thereon accruing after January 1, 1924, and made appropriate endorsement of said guaranty on each of said bonds and redelivered said $3,000,000.00 in par value of said bonds so endorsed to the said St. Louis Union Trust Company. Said $3,000,000.00 in par value of said bonds so endorsed with the guaranty of said Chicago, Milwaukee and St. Paul Railway Company were thereupon delivered by said St. Louis Union Trust Company as syndicate manager, and have since been sold, transferred, assigned and negotiated from time to time by the various holders thereof and are now outstanding in the hands of the public (R. 312).

Said $2,700,000.00 in par value of said Gary bonds delivered by St. Louis Union Trust Company to said Chicago, Milwaukee and St. Paul Railway Company were not guaranteed or endorsed by said Chicago, Milwaukee and St. Paul Railway Company, but were held and owned, along with all of the authorized, issued and outstanding capital stock of said Chicago, Milwaukee and Gary Railway Company, as the property and assets of said Chicago, Milwaukee and St. Paul Railway Company (R. 312).

Thereafter, pursuant to certain contracts, agreements, transactions, plan of reorganization and court proceedings, all the right, title and interest of said Chicago, Milwaukee and St. Paul Railway Company in and to said $2,700,000.00 par value of said Gary bonds, and in and to all of the authorized, issued and outstanding capital stock of the said Chicago, Milwaukee and Gary Railway Company, was transferred, assigned, conveyed and set over to the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, the debtor herein, which has ever since been and is now the owner of all of said stock.

Thereafter, by an agreement dated May 10, 1929, between Chicago, Milwaukee, St. Paul and Pacific Railroad Company, party of the first part, Chicago, Milwaukee and Gary Railway Company, party of the second part, and such of the holders of the first mortgage 5 per cent gold bonds of Chicago, Milwaukee and Gary Railway Company as might consent thereto, parties of the third part, it was agreed that the Chicago, Milwaukee and Gary Railway Company might abandon its line of railroad between Kirkland, Illinois, and Camp Grant, Illinois, being approximately 15.14 miles in length, which was to be released by the trustee from the lien of the mortgage securing the Gary bonds, and that thereafter the Chicago, Milwaukee and Gary Railway Company should convey to Chicago, Milwaukee, St. Paul and Pacific Railroad Company all of the remaining property of the Chicago, Milwaukee and Gary Railway Company. In consideration of the consent of the assenting bondholders thereto, Chicago, Milwaukee, St. Paul and Pacific Railroad Company assumed the payment of the principal and interest of the assenting Gary bonds, and caused to be endorsed thereon a notation with reference thereto. Thereafter, $2,700,000.00 par value of said Gary bonds, which had not been guaranteed by the old Chicago, Milwaukee and St. Paul Railway Company, and upon which the aforesaid assumption of liability by Chicago, Milwaukee, St. Paul and Pacific Railroad Company had not been endorsed, were pledged by the debtor herein as collateral under its First and Refunding mortgage (R. 1862).

The Modified Plan of Reorganization, approved by the District Court, provides that the holders of the $3,000,000.00 principal amount of guaranteed Gary bonds shall receive for their total claim for principal and accrued interest to December 1, 1938, $2,671,875.00 par value of 5 per cent preferred stock and 8,906¼ shares of common stock of no par value of the new company (R. 1317).

The evidence with respect to the facts which might be considered in determining the fair value for railroad purposes of all carrier property subject to the Gary mortgage is summarized in the supplemental report of the Commission, issued June 4, 1940, in the following language (R. 1308-11):

"The Gary, through its predecessor company, was projected as an outer belt line around the Chicago district from Milwaukee, Wis., through Rockford, Kirkland, Aurora and Joliet, Ill., to Gary, Ind. Only two portions were built, one between Rockford and Aurora, and the other between Joliet and Delmar, Ill., where connection is made with the Terre Haute. Trackage over the Elgin, Joliet & Eastern between Aurora and Joliet was secured to connect the two constructed portions. About 15 miles of that portion of the line between Rockford and Kirkland has been abandoned. At Rockford the Gary serves an extensive industrial area on the east side of the river. Its property there includes certain terminal facilities and industrial tracts. The existing trackage agreement between the debtor and the Elgin, Joliet & Eastern is for a term of 10 years from September 3, 1930, and thereafter until either party gives six months notice of its desire to terminate it. By this agreement the train-mile charge was raised from $0.75 as provided in the previous agreement to $1.75, and the minimum rental per day from $33.75 to $75. It prohibits the debtor from transporting, over that portion of line covered by the agreement, traffic originating at or destined to the Joliet and Aurora switching areas, except company material. It restricts the freight to be handled by the debtor over that portion of line to such traffic as is handled in road-haul service by the debtor exclusively and to such traffic as 'originates at and also is destined to points on' the debtor's system, except that the debtor may haul over that section of line traffic between points of origin or destination on its system and points of origin or destination on lines of railroads which con-

nect with it at points west and north of the Illinois and Des Plaines Rivers. Thus, the transportation of traffic to the East over this portion of line is very much restricted, if not entirely prohibited.

"Prior to 1930, while the debtor, as the sole holder of the Gary's stock, operated the Gary's property as part of its system, separate reports for the Gary were kept. In the six-year period 1922-27 it had an average yearly deficit of $58,908 before interest. In 1928 and 1929 it earned $133,350 and $180,622, respectively, for the $150,000 of interest on the outstanding bonds. Since the consolidation of the properties of the Gary with those of the debtor in 1930, separate reports have not been kept. However, the debtor, using transportation records of shipments transported, and applying divisions of tariff rates in effect prior to 1930, estimated that in 1933, 1934, and 1936, the property of the Gary earned for interest $142,000, $60,000 and $54,161, respectively.

"A substantial part of the freight movements over the Gary property is 'bridge traffic' between Delmar and Kirkland. In 1928, for example, this bridge traffic produced revenues of $325,537, divided $108,839 from commercial traffic, and $216,698 from company material, mostly coal, from the Terre Haute lines, at tariff rates. In 1936 the commercial bridge traffic produced only $4,523 in revenues and the company material produced $222,913 (at divisions of tariff rates in effect prior to 1930), a total of $227,436. This bridge traffic could have moved via Blue Island and Bensenville. The debtor explains that the only reason this bridge traffic was moved over the Gary was that it was found economical to fill out trains over the Gary with this traffic in view of its contract with the Elgin, Joliet & Eastern to pay a minimum trackage rental whether the line was used or not, and because of its having to maintain service for certain local industries on the Gary, principally the American Steel & Wire Company at De Kalb. By substituting the estimated cost of $98,918 for moving this bridge traffic over the Bensenville route for the $227,436 revenues on it, at so-called

tariff rates over the Gary in 1936, the debtor estimates that the total revenue properly attributable to the traffic that moved over the Gary property would be $303,524, and that there would result a deficit of $45,816, before interest in that year. By similar computations it estimated deficits before interest for 1928, 1933 and 1934 of $5,187, $34,000 and $84,000, respectively, and $7,510 available for interest in 1929.

"The debtor regards these results as more accurately indicating the earning power of the Gary property than by the use of the old tariff rates on the bridge traffic. It, however, submitted certain estimates to show the worth of the traffic which the Gary properties otherwise contribute to the debtor's system. Based upon transportation records for 1936 and divisions of tariff rates applicable prior to 1930, revenues derived by the debtor from traffic originated, terminated or interchanged with other lines at points on the Gary were $418,316, of which $307,285 was derived from traffic to or from Rockford, and $111,031 to or from all other stations on the Gary. The debtor estimates that it would lose 75 per cent of that traffic, or revenues amounting to $313,737, if it lost control of the Gary property, and that by deducting from such revenues of $313,737 the estimated cost of $218,988 (using system freight operating ratio of 69.8 per cent) of handling the freight producing that revenue, the resulting amount of $94,749 would represent the worth to the debtor's system that would be lost to the system if the control of the Gary were lost. The debtor then applies to the $94,749 the deficit before interest of $45,816, computed as above shown, and treats the resulting net, amounting to $48,933, as representing an approximate equivalent of what the Gary produced for the system for interest in 1936. Similar estimates of $129,927 in 1928, $145,210 in 1929, $25,218 in 1933, and a deficit of $32,813 in 1934, developed by similar methods, are shown. The trustee under the Gary mortgage points out that the debtor could more appropriately have used a ratio of 50 per cent, instead of its system ratios ranging from 64.3 to 69.8 per cent in computing the

cost of handling the contributed traffic beyond the points of interchange with the Gary.

"As of December 31, 1935, the cost of reproduction less depreciation of the Gary property plus value of lands and rights, determined in accordance with methods frequently explained in our reports dealing with valuation for rate-making purposes, was $2,284,008. The final rate-making value as found by division 1 as of June 30, 1915, was $2,789,475.

"It is apparent to us that the Gary property, split into three disconnected portions as it is, and so dependent upon the Elgin, Joliet & Eastern, a competing line, for the much restricted trackage rights described, has very limited earning power as a railroad. The property and facilities at Rockford, however, are fairly productive of revenues not only for the Gary property as such, but also for the debtor's system, as above indicated. Under all the circumstances we are of the opinion that the Gary bondholders should receive somewhat better treatment in the allocation of new securities than in the approved plan, and we accordingly find that the plan should be modified so as to allocate to the Gary bondholders 75 per cent of the principal of their claims, including accrued interest, in new preferred stock, on the basis of $100 par value of preferred stock for each $100 of claim, and the remainder thereof in new common stock on the basis of one share of common stock for each $100 of claim."

In the above-quoted statement the Commission points out that the earnings from the Gary line for the six-year period from 1922 to 1927 show an average yearly deficit of $58,908.00 for interest. While this statement is technically true, it should also be noted that the total net deficit for the said six-year period was $353,449.16, while the deficit for the year 1922—the year of the great shopmen's strike—was $639,291.44. Thus, if we eliminate this wholly abnormal year, the earnings for the other five years of this six-year period showed an average of $57,168.46 available for interest.

Out of the fifteen-year period from 1925 to 1940 we have in the record actual earnings figures for five years and estimates made by the debtor for three. The uncontradicted testimony shows that the net income of the Gary line for the payment of interest on and principal of the Gary bonds, as shown by the books of that company, for the years 1925 to 1929, inclusive, was as follows:

1925	$245,177.00
1926	206,919.00
1927 (Deficit due to coal strike)	25,955.00
1928	133,350.00
1929	180,622.00

For the years 1933; 1934 and 1936 the net income, computed upon the same basis, was estimated as follows:

1933	$142,000.00
1934	60,000.00
1936	54,161.00

(No figures, actual or estimated, are available for any other years during said fifteen [15] year period.) The average net income available for the payment of interest upon and principal of the Gary Bonds for the eight years indicated was $124,534.00, or more than enough to pay four per cent (4%) interest on the $3,000,000.00 of said bonds guaranteed and outstanding in the hands of the public.

In connection with these figures two facts should be noted. In the first place, they do not take into account any contribution to system earnings which is made by the Gary line. In the second place, the revenues are computed without the allowance of a minimum mileage pro rate or of a constructive mileage block or any other allowance such as is customarily made in computing a branch line's share of revenues (R. 1310-11).

C. E. Cribben, an engineer on the staff of the Chicago, Milwaukee, St. Paul & Pacific Railroad Company, testifying for the respondents, stated that he had prepared a

study of the salvage value of certain items of equipment and certain items of property subject to the lien of the Gary mortgage, that it covered ties, rails, angle bars, frogs, switches, tie plates and all metal equipment and all metal material, not including any real estate, except some station buildings and roadway buildings. His estimate of the net salvage value of the items is $255,060.00 (R. 1757-1758).

Louis B. Beardslee, an expert in the appraisal of industrial properties, who has had long experience in the making of appraisals, including appraisals for the Debtor, and of whom the District Court said, "I think we will acknowledge he is an expert" (R. 1760), testified that the fair market value of the real estate and improvements subject to the Gary mortgage, amounted to $725,257.51. In this appraisal he included no value for the line of railroad as such, but appraised merely the underlying real estate on the basis of "what I believe those properties could be sold for in the open market in a reasonable time" (R. 1765).

Roland C. Behrens, vice-president of the St. Louis Union Trust Company, who had had twenty-three years experience in analytical work and in investment analyses for that company, and who is the head of the investment department of the St. Louis Union Trust Company, and who had had much experience in the analyses of securities and railroad securities, and who had had five years of technical training in commercial finance, testifying for the respondents, stated that he had made an analysis of the modified plan of reorganization with particular reference to the preferred stock, and the no par value common stock of the line (R. 1766-1767). The District Court, admitting the competency and the ability of the witness, sustained an objection to his giving his opinion of the value of the preferred and common stock provided for by the plan of reorganization on the ground that it did not mean anything (R. 1770-71).

Thereupon the respondents offered to prove by the witness that in his opinion the actual market value on a "when, as and if basis" of the preferred stock proposed to be issued under the modified plan of reorganization would be not in excess of $4.00 per share, and that the value of the common stock supposed to be issued under the plan of reorganization would be not in excess of $2.00 per share, and that in his opinion the actual or intrinsic value of the stock, fully apart from what it might bring on the market, would be no greater than the figures quoted for the respective market values (R. 1771-1772).

Respondents duly objected to the modified plan of reorganization before the Interstate Commerce Commission and in the District Court, but without avail (R. 1354).

Specifically, respondents, in addition to objecting to the merits of the Modified Plan of Reorganization, objected to the failure of the Commission to make appropriate findings, in the following language:

> "The Objectors object to said Modified Plan of Reorganization and findings of the Commission, because the Commission failed to determine the value of the property subject to the lien of the indenture securing said Gary Bonds, and failed to certify such value to the Court in its Report on the plan, although it was necessary for the commission to determine such value for the purpose of determining whether or not the plans of reorganization proposed to the Commission and the Modified Plan of Reorganization approved by the Commission were fair and equitable, afforded due recognition to the rights of each class of creditors and stockholders, did not discriminate unfairly in favor of any class of creditors or stockholders, and would conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders" (R. 1357-1358).

The Interstate Commerce Commission did not, in the Modified Plan of Reorganization approved by the Commis-

sion, or in the findings of the Commission, all as set forth and contained in the Report of the Commission of February 12, 1940 (R. 2153-2267), or in the Order of the Commission of even date therewith (R. 1258-1283), or in the Supplemental Report of the Commission of June 4, 1940 (R. 1286-1315), or in the Supplemental Order of the Commission of even date therewith (R. 1319-1347), or in any other order, finding or report, determine the value of the property pledged as security for the Gary Bonds and certify the same to the Court in its report on the plan, or make any other findings of value as required by law. On the above record respondents contend that the failure of the Commission to make the requisite findings of value constituted a fatal defect in the plan and proceedings, and that the decision of the Court below in reversing the order of the District Court and directing the District Court to remand the case to the Interstate Commerce Commission, is correct. Respondents also contend that, on its merits, the Modified Plan of Reorganization is not fair and equitable, does not afford due recognition to the rights of each class of creditors, discriminates unfairly in favor of other creditors, and will not conform to the requirements of the law of the land regarding the participation of the various classes of creditors, and that the consummation of the Plan would constitute the taking of the property of the holders of the Gary Bonds without due process of law, contrary to the Fifth Amendment to the Constitution of the United States of America.

ARGUMENT.

I.

The Decision of the Court Below Ordering the Remanding of the Case to the Interstate Commerce Commission for the Making of Findings, and, If Necessary, the Taking of Additional Evidence, in Order That Additional Findings May Be Made, Is Correct.

(a) In accordance with the rule announced in the Consolidated Rock Products Company case, specific findings of value must be made.

The Court below found that the Interstate Commerce Commission had failed to make the requisite findings of values, and, because of the absence of such findings, reversed the order of the District Court "with directions to the District Court to set aside its order of approval and to remand the case to the I. C. C. for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made, as heretofore indicated" (R. 2317). The Court based its ruling squarely upon the decision of this Court in the case of **Consolidated Rock Products Co. v. Du Bois**, 312 U. S. 510.

In that case, arising under section 77-B, reorganization was sought of a parent corporation and its two subsidiaries, referred to in the opinion as Consolidated, Union and Consumers, respectively. This Court said, l. c. 607:

> "The District Court did not find specific values for the separate properties of Consolidated, Union, or Consumers, or for the properties of the enterprise as a unit."

In holding that this failure on the part of the District Court was fatal to any determination of the fairness of the plan, this Court further said, l. c. 609:

"On this record no determination of the fairness of any plan of reorganization could be made. Absent the requisite valuation data, the court was in no position to exercise the 'informed, independent judgment' * * * which appraisal of the fairness of a plan of reorganization entails. * * * There are two aspects of that valuation problem.

"In the first place, there must be a determination of what assets are subject to the payment of the respective claims. This obvious requirement was not met. * * *

"We have already noted that no adequate finding was made as to the value of the assets of Consolidated. In view of what we have said, **it is apparent that a determination of that value must be made so that criteria will be available to determine an appropriate allocation of new securities between bondholders and stockholders in case there is an equity remaining after the bondholders have been made whole.**

"There is another reason why the failure to ascertain what assets are subject to the payment of the Union and Consumers bonds is fatal. There is a question raised as to the fairness of the plan as respects the bondholders inter sese. While the total mortgage debt of Consumers is less than that of Union, the net income of the new company, as we have seen, is to be divided into two equal parts, one to service the new securities issued to Consumers bondholders, the other to service those issued to Union bondholders. That allocation is attacked here by respondent as discriminatory against Union, on the ground that the assets of Union are much greater in volume and in value than those of Consumers. It does not appear from this record that Union and Consumers have individual earnings records. If they do not, **some appropriate formula for at least an approximate ascertainment of their respective assets must be designed in spite of the difficulties occasioned by the commingling.** Otherwise **the issue of fairness of any plan of reorganization as between Union and Consumers bondholders cannot be intelligently resolved.**" (Emphasis ours.)

On the record as made in the present case, and with the decision of this Court in the Consolidated Rock Products Company case before it, the Court below had no alternative in the matter. As it said in its opinion, "The explicit holding of the Consolidated Rock Products case is so mandatory that further discussion is unnecessary" (R. 2316).

The rights of the parties which have been violated by the failure of the Commission to make the requisite findings were summed up by the Court below in a single sentence:

> "It may be observed that in our opinion there is evidence in the record to support the plan as proposed, but it cannot receive final approval until and unless there are findings made upon such evidence; **and then the parties interested may have the right to review both the sufficiency of the findings to support the plan and the existence of evidence to support the findings.**" (Emphasis ours.) (R. 2314.)

We believe that the problem presented by the Gary Bonds and the treatment accorded them in the Modified Plan of Reorganization furnishes a good illustration of the reason for the rule requiring such findings. Although we contend for a far higher value for the railroad property which is the security for the Gary Bonds, the undisputed evidence in the case shows a minimum scrap value of approximately $1,000,000.00 (R. 1757-1758, 1760), or at least 33¢ per dollar of face value of bonds. Respondents offered evidence, which was excluded, tending to show that the securities provided for the Gary Bonds under the Plan of Reorganization would be worth approximately 4¢ per dollar of face value of bonds. If the Commission had made a finding of value for the Gary line of $1,000,000.00, it would have been obvious that such finding could not support the Plan within the absolute priority rule of **Northern Pacific Railroad Co. v. Boyd, 228 U. S. 482; Case v.**

Los Angeles Lumber Products Co., 308 U. S. 106, and **Consolidated Rock Products Co. v. Du Bois, 312 U. S. 510.** If the Commission had made a finding that the value of the Gary line was sufficiently small to correspond to the value of the securities provided for the Gary Bonds, then respondents would have had little difficulty in convincing the Court that there was an utter absence of evidence in the record to support such a finding.

Petitioner Reconstruction Finance Corporation argues in its brief, page 13, that "Universal dollar values are unnecessary and impracticable, and would cloak with delusive exactness the elements of judgment involved." On the contrary, they are both very necessary and very practicable, and are not a mere formality. In dealing with the rights of security holders under the absolute priority rule, we are dealing in dollar values, and it is only in terms of dollars that the test of absolute priority can be applied. It is perfectly practicable for the Commission to make its findings in terms of dollar values, because, as pointed out by petitioners Group of Institutional Investors and Mutual Savings Bank Group in their brief, page 48, "The Commission could and did form the judgments necessary to a fair and equitable allocation of the new securities," and the Court below, in its opinion, pointed out that "it may well be argued that the I. C. C. could make such findings by taking notice of its reports and the statistical information in its files bearing upon the income of this railroad and of its various branches" (R. 2315). If the Commission could and did form the judgments necessary to a fair and equitable allocation of the new securities, it must have done so in terms of dollars. Certainly there is no other way recognized by law whereby the value of railroad property may be measured in terms of securities, or securities in terms of railroad property, except by reference to a common yardstick, that of the dollar.

(b) In accordance with the specific provisions of Subsection (e) of Section 77 the Interstate Commerce Commission is required to determine values and certify the same to the Court in its report on any reorganization plan.

Above and beyond the general rule enunciated by this Court in the Consolidated Rock Products case requiring findings of value in connection with any plan of reorganization, we have in **Subsection (e) of Section 77 of the Bankruptcy Act, as amended, 11 U. S. C. A. 205 (e)**, the following specific mandate to the Interstate Commerce Commission with respect to railroad reorganizations:

> "If it shall be necessary to determine the value of any property for any purpose under this section, the Commission shall determine such value and certify the same to the Court in its report on the plan."

That it was necessary for the Commission to determine the value of the property securing the Gary bonds for the purpose of determining what treatment should be given to the holders of such bonds in a plan of reorganization is so obvious that it should require no argument. Without a determination as to the value of the property securing the Gary bonds, as well as the values of the properties securing the other issues of bonds involved in this proceeding, it was utterly impossible for the Commission, or anyone else, to decide whether or not the various plans of reorganization proposed to the Commission and the Modified Plan of Reorganization approved by the Commission were fair and equitable, afforded due recognition to the rights of each class of creditors, did not discriminate unfairly between any class of creditors and stockholders, and would conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders.

This principle was expressly recognized by this Court

in its decision in the case of **Consolidated Rock Products Co. v. Dubois, 312 U. S. 510.**

In the case of **In re Western Pac. R. Co., 124 Fed. (2d) 136,** the Ninth Circuit Court of Appeals pointed out that in order to determine the value of the various creditors' claims it was necessary to determine the value of the property pledged to secure each such claim. It also pointed out that in order to determine the value of the new securities proposed in the plan of reorganization it would be necessary to determine the value of the property which would be pledged to secure their payment. The Court then said (l. c. 139-140):

> "It thus became the duty of the Commission to determine these values and certify them to the Court. That duty was not performed.
>
> "Lacking the requisite valuation data, the Court was in no position to exercise the 'informed, independent judgment' which appraisal of the fairness of a plan of reorganization entails. Consolidated Rock Products Co. v. Dubois, supra (312 U. S. 510, 61 S. Ct. 682, 85 L. Ed. 982). See, also, National Surety Co. v. Coriell, 289 U. S. 426, 436, 53 S. Ct. 678, 77 L. Ed. 1300, 88 A. L. R. 1231; First National Bank v. Flershem, 290 U. S. 504, 525, 54 S. Ct. 298, 78 L. Ed. 465, 90 A. L. R. 391; Case v. Los Angles Lumber Products Co., 308 U. S. 106, 115, 60 S. Ct. 1, 84 L. Ed. 110."

So in the present case the Commission could not determine whether any plan of reorganization was fair and equitable and did not discriminate unfairly in favor of any class of creditors, in so far as the Gary bondholders were concerned, without determining the value of the security behind such bonds as well as the value of the security behind each of the other classes of secured creditors. Disregarding the question of discimination, of relative treatment as between different classes of creditors, it was impossible for the Commission or the District Court to de-

termine whether or not the Modified Plan of Reorganization approved by the Commission conformed to the requirements of the law of the land without determining the value of the property subject to the lien of the mortgage securing the Gary bonds. It is of course impossible to say whether or not the absolute priority rule of **Northern Pacific Railroad Company v. Boyd**, 228 U. S. 482, 57 L. Ed. 931, 33 S. Ct. 554, and **Case v. Los Angeles Lumber Products Company**, 308 U. S. 106, 84 L. Ed. 110, 60 S. Ct. 1, has been complied with if we do not know the value of the security out of which the bondholders are entitled to priority in payment.

We conceive the above quoted provision of the Bankruptcy Act to be something more than a mere guide which may or may not be followed by the Interstate Commerce Commission in its discretion. It is mandatory by its very terms and is apparently based upon the fundamental conception of Congress as to the relative function and duty of the Commission and of the Court in railroad reorganization proceedings. Apparently Congress conceived of the Interstate Commerce Commission as being peculiarly well fitted to determine the values of railroad properties and of the courts as being peculiarly well fitted to determine whether or not, based upon such values, a plan of reorganization is fair and equitable, does not discriminate unfairly between different classes of creditors, and complies with the law of the land. It will be noted that this section of the law not only provides for the Commission to determine the values, but expressly provides that the Commission shall certify the same to the Court in its report on the plan. Congress evidently wished to give the District Court the benefit of the express findings of the Commission with respect to the values of the different parts of a railroad system in order that the Court might determine whether or not a plan of reorganization setting up a new capital

structure and allocating new securities between different classes of creditors is fair and equitable, does not discriminate unfairly and conforms to the requirements of the law of the land. Without a determination of such values, neither the Commission nor the Court could properly perform their separate duties.

We also believe that this provision of the law is intended to serve a second function. It is not only intended to furnish the Court with information as to the value of the railroad properties, from which the Court may determine the legality of a plan of reorganization, but it is also intended to furnish the creditors and stockholders themselves with information with respect to the values of the properties behind their several securities in order that they may have the benefit of such information in voting to accept or reject any plan of reorganization.

That the failure of the Interstate Commerce Commission to comply with the above quoted express provision of the statute rendered its order approving the Modified Plan of Reorganization void is established by decisions of the Supreme Court in comparable cases. Thus, in the case of **Wichita Railroad & Light Company v. Public Utilities Commission of the State of Kansas et al.**, 260 U. S. 48, a gas company sought an order from the Public Utility Commission established under the Public Utility Law of Kansas increasing rates and superseding lower rates fixed by its contract with a street railway and lighting company. Section 13 of the Public Utility Law provided that:

> "It shall be the duty of the commission, either upon complaint or upon its own initiative, to investigate all rates, * * * and if after full hearing and investigation the commission shall find that such rates * * * are unjust, unreasonable, unjustly discriminatory or unduly preferential, the commission shall have power to fix and order substituted therefor such rate or rates * * * as shall be just and reasonable."

The Commission made an order approving higher rates, but did not expressly find that the existing rates were unjust, unreasonable, unjustly discriminatory or unduly preferential. This Court held that this was a fatal defect and that the Commission's order was void, saying, l. c. 58, 59:

> "The proceeding we are considering is governed by Section 13. That is the general section of the act comprehensively describing the duty of the Commission, vesting it with power to fix and order substituted new rates for existing rates. The power is expressly made to depend on the condition that after full hearing and investigation the Commission shall find existing rates to be unjust, unreasonable, unjustly discriminatory or unduly preferential. **We conclude that a valid order of the Commission under the act must contain a finding of fact after hearing and investigation upon which the order is founded, and that for lack of such a finding the order in this case was void.**
>
> "This conclusion accords with the construction put upon similar statutes in other States. Public Utilities Commission v. Springfield Gas & Electric Co., 291 Ill. 209; Public Utilities Commission v. Baltimore & Ohio Southwestern R. R. Co., 281 Ill. 405. **Moreover, it accords with general principles of constitutional government.** The maxim that a legislature may not delegate legislative power has some qualifications, as in the creation of municipalities, and also in the creation of administrative boards to apply to the myriad details of rate schedules the regulatory police power of the State. The latter qualification is made necessary in order that the legislative power may be effectively exercised. In creating such an administrative agency the legislature, to prevent its being a pure delegation of legislative power, must enjoin upon it a certain course of procedure and certain rules of decision in the performance of its function. **It is a wholesome and necessary principle that such an agency must pursue the procedure and rules enjoined**

and show a substantial compliance therewith to give validity to its action. When, therefore, such an administrative agency is required as a condition precedent to an order to make a finding of facts, the validity of the order must rest upon the needed finding. If it is lacking, the order is ineffective.

"It is pressed on us that the lack of an express finding may be supplied by implication and by reference to the averments of the petition invoking the action of the Commission. We cannot agree to this. It is doubtful whether the facts averred in the petition were sufficient to justify a finding that the contract rates were unreasonably low; but we do not find it necessary to answer this question. We rest our decision on the principle that **an express finding of unreasonableness by the Commission was indispensable under the statutes of the State.**" (Emphasis ours.)

In the case of **United States v. Baltimore & Ohio Railroad Company**, 293 U. S. 454, this Court had before it for consideration an order under the Boiler Inspection Act entered by the Interstate Commerce Commission. The Boiler Inspection Act authorized the Interstate Commerce Commission in an appropriate proceeding to forbid the use of a locomotive equipped with a manually operated reverse gear if by reason thereof the engine would be rendered unsafe or would subject the employees of the railroad or others to "unnecessary peril of life or limb." The report of the Commission failed to contain a specific finding that the locomotive in question caused unnecessary peril to life and limb, and the Court held that this constituted a fatal defect, saying, l. c. 463:

"The primary question of fact presented for determination was, as the report of the Commission states, 'whether the use of locomotives equipped with hand reverse gear, as compared with power reverse gear, causes unnecessary peril to life or limb.' The report discusses, at some length, the alleged advantages and

disadvantages of the two classes of reverse gear and the expense which the proposed change would entail; and concludes with 'finding' that, to a certain extent, the change should be made. But whether the use of any or all types of steam locomotives 'equipped with hand reverse gear as compared with power reverse gear causes unnecessary peril to life or limb,' is left entirely to inference. **This complete absence of 'the basic or essential findings required to support the Commission's order' renders it void.** Florida v. United States, 282 U. S. 194, 215. Compare Wichita Railroad & Light Co. v. Public Utilities Comm'n, 260 U. S. 48, 58-59; Mahler v. Eby, 264 U. S. 32, 44-45.

"In the Florida case the legal distinction was pointed out between what may be termed quasi-jurisdictional findings, there held to be indispensable, and the 'complete statement of the grounds of the Commission's determination' which was declared in Beaumont, St. L. & W. Ry. Co. v. United States, 282 U. S. 74, 86, to be desirable for a proper consideration of the case in the courts. The lack of such a complete statement, while always regrettable, because unnecessarily increasing the labor of the reviewing court, compare Virginia Ry. v. United States, 272 U. S. 658, 675, is not fatal to the validity of the order. It is true that formal and precise findings are not required, under Section 14 (1) of the Interstate Commerce Act, which declares that the report 'shall state the conclusions of the Commission together with its decision.' Compare Manufacturers Ry. Co. v. United States, 246 U. S. 457, 487; Meeker & Co. v. Lehigh Valley R. Co., 236 U. S. 412, 428. That provision relieves the Commission from making comprehensive findings of fact similar to those required by Equity Rule 70½. But Section 14 (1) does not remove the necessity of making, where orders are subject to judicial review, quasi-jurisdictional findings essential to their constitutional or statutory validity." (Emphasis ours.)

In view of the above, it would seem clear that the ruling of the Court below in reversing the order of the District

Court and in directing the District Court to remand the case to the Commission for the making of findings can be supported not only on the authority of the decision in the Consolidated Rock Products Company case, but also on the ground that the Commission failed to comply with the specific and unequivocal provisions of Section 77 (e) of the Bankruptcy Act, as amended.

II.

The Modified Plan of Reorganization Is Not Fair and Equitable, Does Not Afford Due Recognition to the Rights of Each Class of Creditors, Discriminates Unfairly in Favor of Other Creditors, and Will Not Conform to the Requirements of the Law of the Land Regarding the Participation of the Various Classes of Creditors.

Under the express provisions of Section 77 (e) of the Bankruptcy Act any plan of reorganization of a railroad company debtor must be fair and equitable, must afford due recognition to the rights of each class of creditors, must not discriminate unfairly in favor of any class of creditors and must conform to the requirements of the law of the land regarding the participation of the various classes of creditors. We submit that upon the undisputed facts in this case the Modified Plan of Reorganization does not comply with, but on the contrary violates, each of these requirements.

The uncontradicted testimony shows that the net income of the Chicago, Milwaukee and Gary Railway Company available for the payment of interest on and principal of said Gary Bonds, as shown by the books of that company, for the years 1925 to 1929, inclusive, was as follows:

1925	$245,177.00	
1926	206,919.00	
1927	25,955.00	(Deficit—due to coal strike)
1928	133,350.00	
1929	180,622.00	

For the years 1933, 1934 and 1936 the net income computed upon the same basis was estimated as follows:

1933	$142,000.00
1934	60,000.00
1936	54,161.00

The average net income available for the payment of interest upon and principal of the Gary Bonds for the eight years indicated was $124,534.00, or more than enough to pay four per cent (4%) interest on the $3,000,000.00 of said bonds guaranteed and outstanding in the hands of the public.

In connection with these figures two facts should be noted. In the first place, they do not take into account any contribution to system earnings which is made by the line securing the Gary Bonds. In the second place, the revenues are computed without the allowance of a minimum mileage prorate or of a constructive mileage block or any other allowance such as is customarily made in computing a branch line's share of revenues.

That this line's contribution to system earnings is substantial seems to be unquestioned. According to Exhibits Nos. 85 and 143, the estimated net earnings of the balance of the system on business contributed by the Gary line for the years 1928, 1929, 1933, 1934 and 1936, were as follows:

1928	$135,114.00
1929	132,700.00
1933	59,218.00
1934	51,187.00
1936	94,749.00

In this connection it will be noted that in arriving at these figures the cost of handling this traffic has been based upon the system freight operating ratios running from 64.3 per cent to 69.8 per cent, instead of the customary figure of 40 per cent to 50 per cent, which is used generally by other

roads in estimating the cost of handling such traffic. **If the cost of handling this traffic be estimated at 50 per cent, then these average net earnings of the balance of the system on traffic contributed by the Gary line would be $146,399.00, which, when added to the average net income of the Gary line itself, amounting to $124,534.00, as indicated above, gives a total of $270,933.00 for the average net income, plus average system earnings, or more than nine per cent (9%) on the $3,000,000.00 guaranteed Gary Bonds outstanding in the hands of the public.** Even if we accept the method of computation used in the preparation of Exhibits Nos. 85 and 143, the average system earnings on this traffic for the five years for which these figures are available is $95,593.00. If this figure be added to the eight-year average net earnings of the Gary line, as indicated above, amounting to $124,534.00, we have a total of $220,127.00, or more than seven per cent (7%) on the $3,000,000.00 Gary bonds outstanding in the hands of the public and guaranteed.

It is perfectly true that in Exhibits Nos. 85 and 143 the Debtor has attempted to repudiate the method which it followed in keeping the books of the Chicago, Milwaukee and Gary Railway Company up to 1930, and to minimize the net income of this line by substituting for revenues at tariff rates on bridge traffic the estimated cost of handling the traffic via Bensenville, and allowing credit for movement of empty cars for Milwaukee account. We will not attempt at this time to discuss this method of computation, or to point out the disadvantages of handling this traffic via Bensenville, such as the longer time in transit and additional congestion. It is sufficient to say that the net income as hereinabove indicated is based upon the traffic as it has been and is now actually being handled, and upon the method which the Debtor followed in computing the net income of this line of road for many years prior to the institution of the present proceedings, when

there was no occasion to either magnify or minimize such net income.

In acquiring the Gary line the Debtor acquired valuable terminal properties at Rockford, Illinois. The Debtor's line enters Rockford via the Burlington on the west side of the river and, prior to the acquisition of the Gary line, the Debtor did not serve the industrial section on the east side of the river which was served by the Gary line. As of June 1, 1935, the I. C. C. valuation of the Rockford terminal properties was $497,000.00. The value of this terminal to the Debtor is clearly demonstrated by Exhibit No. 87. This exhibit shows that the Debtor's portion of total freight revenues on traffic received and forwarded by it at Rockford increased from $408,000.00, in the year 1921, to $751,000.00 in the next year (the Gary line having been acquired as of December 31, 1921), and to a maximum of $1,441,000.00 in the year 1929. **The average for the Debtor's portion of the total freight revenues at Rockford increased from $466,750.00 for the four years from 1918 to 1921, inclusive, to an average of $935,692.00 for the thirteen years from 1922 to 1934, inclusive.**

Finally, it should be noted that the I. C. C. valuation of the Gary line is $2,789,475.00 (R. 1311) and the book value on the Debtor's books $2,745,173.00.

Upon the facts as above outlined, we submit that the proposed plan of reorganization is not equitable, discriminates unfairly in favor of certain classes of creditors and stockholders, is not financially advisable, does not meet with the requirements of Subdivision (e) of Section 77 of the Bankruptcy Act, as amended, fails to preserve the existing rights and priorities of the holders of the Gary Bonds over the holders of the other bonds and securities proposed to be affected by said plans of reorganization.

In the light of the above evidence it is apparent that the modified plan of reorganization violates the so-called "rule of the Boyd case," is not fair and equitable within the

meaning of Section 77 of the Bankruptcy Act, and will not conform to the requirements of the law of the land as enunciated in the following cases:

Northern Pacific Railway Co. v. Boyd, 228 U. S. 482;
Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 79 Law. Ed. 1593, 55 Sup. Ct. 854;
Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 84 Law. Ed. 22, 60 Sup. Ct. 1.

III.

The Consummation of the Modified Plan of Reorganization Would Constitute the Taking of the Property of the Holders of the Gary Bonds Without Due Process of Law, Contrary to the Fifth Amendment to the Constitution of the United States of America.

Even if we disregard all of the evidence in the record with respect to the value of the Gary line as a railroad property and consider only the uncontradicted testimony with respect to the scrap value of the metal equipment and material amounting to $255,060.00 (R. 1757-58) and the evidence with respect to the value of the real estate, for real estate purposes, of $725,257.51 (R. 1758-60), we have a minimum value of the security behind the Gary bonds of $980,317.51. In return for this security the Gary bondholders are asked to accept preferred and common stock which can be demonstrated to have a fair market value amounting to far less than the minimum scrap or abandonment value of the Gary property. To compel the Gary bondholders to accept such a plan of reorganization would clearly constitute a taking of their property without due process of law, contrary to the Fifth Amendment to the Constitution of the United States of America.

Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 589, 590, 79 Law. Ed. 1593, 55 Sup. Ct. 854.

IV.

Conclusion.

We respectfully submit that inasmuch as the Interstate Commerce Commission failed to make the findings required in accordance with the principle enunciated by this Court in the case of **Consolidated Rock Products Co. v. DuBois**, 312 U. S. 510, and also failed to comply with the mandatory provisions of Section 77 (e) in failing to determine the value of the property subject to the lien of the indenture securing the Gary Bonds and in failing to certify such value to the Court in its report on the plan, the decision of the Circuit Court of Appeals should be affirmed in so far as it reverses the order of the District Court and directs the District Court to set aside its order of approval and to remand the case to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings may be made.

We further submit that inasmuch as the Modified Plan of Reorganization, as approved and ordered put in force by the Commission, is not fair and equitable, does not afford due recognition to the rights of each class of creditors, discriminates unfairly in favor of other creditors, will not conform to the requirements of the law of the land regarding the participation of the various classes of creditors, and constitutes the taking of the property of the holders of the Gary Bonds without due process of law, contrary to the Fifth Amendment, the Interstate Commerce Commission

should also be directed to submit a new Plan of Reorganization which will be fair and equitable in so far as the holders of the Gary Bonds are concerned.

Respectfully submitted,

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